

## Message Text

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INFORM CONSULS

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SUBJECT: CURRENT ECONOMIC DEVELOPMENTS: RECYCLING

1. SUMMARY. THIS REPORT SURVEYS THE BASIC NATURE AND DIMENSIONS OF THE SO-CALLED QUOTE RECYCLING PROBLEM UNQUOTE, REVIEWS SOME OF THE ISSUES INVOLVED IN CHOOSING APPROPRIATE POLICY RESPONSES TO THE PROBLEM, AND INDICATES THE STATE OF PLAY IN INTERNATIONAL POLICY MAKING AS OF THE END OF A SERIES OF IMPORTANT INTERNATIONAL FINANCIAL MEETINGS IN WASHINGTON, JANUARY 13-17. END SUMMARY.

2. NATURE OF RECYCLING PROBLEMS. QUOTE RECYCLING UNQUOTE IN THIS REPORT REFERS TO THE PROCESS BY WHICH THE LARGE SURPLUS OF FOREIGN EXCHANGE EARNINGS OF THE OIL EXPORTING LIMITED OFFICIAL USE  
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COUNTRIES RETURNS AS INTERNATIONAL CAPITAL FLOWS TO THE REST OF THE WORLD AND SERVES IN THE PROCESS TO FINANCE THE REST OF THE WORLD'S AGGREGATE CURRENT ACCOUNT DEFICIT RESULTING FROM THE MASSIVE OIL PRICE INCREASE. IN THE

AGGREGATE, THERE IS NO RECYCLING PROBLEM. THE SURPLUSES OF THE OPEC COUNTRIES WILL NECESSARILY RETURN TO THE OIL IMPORTING COUNTRIES WITHOUT ANY SPECIAL INCENTIVES OR FACILITIES. NEVERTHELESS, THERE ARE AT LEAST TWO IMPORTANT KINDS OF RECYCLING PROBLEMS: THE FIRST INVOLVES THE STRAINS ON THE CAPACITY OF PRIVATE FINANCIAL INSTITUTIONS WHICH SERVE AS INTERMEDIARIES FOR THE BULK

OF THE ENORMOUS VOLUME OF OIL FUNDS. THE SECOND RELATES TO THE DISTRIBUTION OF THE RETURN FLOWS AMONG COUNTRIES. FOR INDIVIDUAL COUNTRIES, THE DIRECT FLOWS OF CAPITAL FROM OIL EXPORTERS MAY NOT MATCH THE OIL-RELATED INCREASE IN THEIR CURRENT ACCOUNT DEFICITS AND THEY MAY HAVE DIFFICULTIES IN OBTAINING, DIRECTLY OR INDIRECTLY, A SUFFICIENT PORTION OF THESE CAPITAL FLOWS TO FINANCE THEIR DEFICITS AT REASONABLY STABLE EXCHANGE RATES.

3. THE SECOND OF THESE MAJOR PROBLEMS HAS ATTRACTED THE MOST OFFICIAL ATTENTION. IT HAS BEEN THE SUBJECT OF MAJOR POLICY INITIATIVES AND INTENSIVE INTERNATIONAL STUDY AND NEGOTIATIONS, MOST RECENTLY IN THE WASHINGTON MEETINGS OF THE GROUP OF TEN MINISTERS, THE IMF INTERIM COMMITTEE, AND THE IMF/IBRD DEVELOPMENT COMMITTEE, AND IS THE MAJOR FOCUS OF THIS REPORT.

4. SOME BASIC FACTS ON RECYCLING. THE CURRENT ACCOUNT SURPLUS OF THE OPEC COUNTRIES WAS ROUGHLY DOLLARS SIXTY

BILLION IN 1974, UP FROM ABOUT DOLLARS FIVE BILLION IN 1973. OF THE DOLLARS SIXTY BILLION, ROUGHLY TWO-THIRDS WAS REFLECTED IN THE DEFICITS OF THE INDUSTRIALIZED COUNTRIES, THE REMAINDER IN DEFICITS IN THE REST OF THE WORLD. A ROUGHLY SIMILAR AMOUNT WILL PROBABLY BE REGISTERED IN 1975.

5. OUR INFORMATION ON THE RETURN FLOWS IS QUITE INCOMPLETE. HOWEVER, IT APPEARS THAT, IN 1974, ABOUT  
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35 PERCENT WAS DEPOSITED IN BANKS IN THE EUROCURRENCY MARKET, MOSTLY IN THE UK, BUT ALSO IN CONTINENTAL EUROPE, AND JAPAN. A LITTLE LESS THAN 20 PERCENT WAS INVESTED IN THE UNITED STATES, MOSTLY IN MARKETABLE GOVERNMENT SECURITIES, AND OTHER LIQUID BANKING AND MONEY MARKET ASSETS. ABOUT 12 PERCENT WAS PLACED IN THE UK IN POUND STERLING ASSETS (AGAIN, MOSTLY LIQUID ASSETS). OTHER DEVELOPED COUNTRIES RECEIVED ALMOST 10 PERCENT IN DIRECT OR QUASI-OFFICIAL BORROWING. LENDING TO INTERNATIONAL FINANCIAL FACILITIES (E.G., IBRD BONDS, IMF OIL FACILITY) AND FLOWS TO LDGS ACCOUNTED FOR ANOTHER 10 PERCENT. ALL THE REST (INCLUDING SOME UNEXPLAINED RESIDUAL) AMOUNTED

TO ABOUT 15 PERCENT.

6. THESE FIGURES HIGHLIGHT THE FACTORS BEHIND THE TWO MAJOR RECYCLING PROBLEMS. FIRST, THE STRONG PREFERENCE OF OPEC COUNTRIES FOR HIGHLY LIQUID ASSETS, PARTICULARLY EURODOLLAR DEPOSITS, HAS PLACED A HEAVY STRAIN ON CERTAIN WESTERN BANKING INSTITUTIONS. SECONDLY, THE CONCEN-

TRATION OF OIL FUNDS IN THE MAJOR FINANCIAL CENTERS HAS MEANT THAT FUNDS HAVE NEEDED TO BE CHANNELED IN TURN TO OTHER COUNTRIES IN NEED OF BALANCE OF PAYMENTS FINANCE. IN EFFECT, FUNDS THAT HAVE BEEN RECYCLED BY OIL EXPORTERS HAVE THEN TO BE QUOTE RESHUFFLED UNQUOTE TO COUNTRIES IN NEED.

7. INSTITUTIONAL PROBLEMS. THE STRAINS RESULTING FROM THE CONCENTRATION OF FLOWS OF SURPLUS OIL EARNINGS IN THE EUROCURRENCY BANKS ARE OF TWO KINDS. FIRST, AND MOST IMPORTANT, IS THE PROBLEM OF ADEQUACY OF BANK CAPITAL. THE SHEER VOLUME OF OIL MONEY FLOWING TO THE LARGEST INTERNATIONAL BANKS--ROUGHLY THE TOP 25--HAS SEVERELY ERODED THESE BANKS' RATIO OF CAPITAL TO LOANS. SINCE BANK CAPITAL PROVIDES A CUSHION AGAINST LOSSES AND INSOLVENCY, THESE RATIOS CANNOT BE ALLOWED TO FALL TOO LOW. AT THE SAME TIME, BANK SHARE ISSUES HAVE BEEN DISCOURAGED BY DEPRESSED EQUITY MARKETS.

8. THE SECOND KIND OF PROBLEM IS THE STRAIN OF INTER-MEDIATING BETWEEN THE SHORT-TERM PREFERENCES OF OPEC  
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LENDERS AND LONG-TERM BORROWERS. BANK VULNERABILITY TO SUDDEN WITHDRAWAL IS ALSO INCREASED BY RELIANCE ON A FEW MAJOR SOURCES OF SHORT-TERM MONEY FOR A LARGE PROPORTION OF THEIR DEPOSITS. AT THE SAME TIME, SOME COUNTRIES--INCLUDING THE FINANCIALLY WEAKER INDUSTRIALIZED COUNTRIES AS WELL AS SOME LDCS--HAVE HAD TO BORROW VERY SUBSTANTIAL AMOUNTS TO COVER THEIR DEFICITS. NORMAL BANKING PRUDENCE SETS LIMITS TO AMOUNTS THAT OUGHT TO BE LENT TO SINGLE BORROWERS, AND THE CREDIT WORTHINESS OF THESE BORROWERS, BY USUAL BANKING STANDARDS, HAS BEEN SUBSTANTIALLY WEAKENED.

9. THE STRAINS PUT ON THESE BANKS, PLUS THE HIGHLY PUBLICIZED FAILURES OF A NUMBER OF SMALLER BANKS (CAUSED BY OVEREXTENSION, BAD MANAGEMENT, AND SPECULATION RATHER THAN BY PETRODOLLAR STRAINS) HAS BADLY DAMAGED CONFIDENCE IN THE BANKING SYSTEM'S ABILITY TO REMAIN SOUND IN THE PRESENT SITUATION. IN RESPONSE TO THIS CONCERN, THE BANKING AUTHORITIES OF MAJOR FINANCIAL COUNTRIES TIGHTENED THEIR REGULATORY PRACTICES AND

REACHED INFORMAL AGREEMENT ON THE DIVISION OF RESPONSIBILITIES FOR INTERNATIONAL BANKS. THE AUTHORITIES CLEARLY HAVE AN INTEREST AND THE CAPABILITY TO AVOID ANY POSSIBILITY OF CUMULATIVE LIQUIDITY CRISIS LEADING TO FINANCIAL PANIC.

10. THE DISTRIBUTION PROBLEM. WHILE THE BULK OF OIL

MONEY HAS BEEN FLOWING INTO A FEW FINANCIAL CENTERS, PARTICULARLY NEW YORK AND LONDON, THE DISTRIBUTION OF INCREASED OIL COSTS IS WIDELY SPREAD--RELATIVELY FEW COUNTRIES ARE SELF-SUFFICIENT, OR NEARLY SO. WITHIN THE OECD AREA, THE LARGEST INCREASES IN OIL IMPORT COSTS IN 1974 HAVE BEEN IN THE UNITED STATES AND JAPAN--DOLLARS 15 BILLION AND DOLLARS 12 BILLION RESPECTIVELY, ACCORDING TO THE OECD. THE UK, ITALY, FRANCE AND GERMANY AMONG THE MAJOR COUNTRIES EACH FELT AN IMPACT OF BETWEEN DOLLARS 5 AND 6 BILLION. (IN RELATIVE TERMS, THE RATIO OF THESE AMOUNTS TO TOTAL 1973 IMPORTS WAS: THE US 21 PERCENT; JAPAN 37 PERCENT; GERMANY 12 PERCENT; FRANCE 18 PERCENT; THE UNITED KINGDOM 16 PERCENT; ITALY 19 PERCENT.) THE LIMITED OFFICIAL USE  
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SMALLER INDUSTRIALIZED COUNTRIES ALSO BORE A SUBSTANTIAL SHARE OF THE BURDEN, ABOUT DOLLARS 10 BILLION, AND COUNTRIES OUTSIDE THE OECD AREA A BURDEN OF ABOUT DOLLARS 20 BILLION. (THE ONLY OECD COUNTRY NOT ADVERSELY AFFECTED IS CANADA, WHICH IS SELF-SUFFICIENT IN OIL.)

11. THE DIFFICULTIES IN DISTRIBUTING OIL MONEY FROM THE MAIN FINANCIAL CENTERS TO THE VARIOUS COUNTRIES IN NEED OF FINANCING WAS EXACERBATED BY AN ALREADY QUITE UNEVEN DISTRIBUTION OF CURRENT ACCOUNT SURPLUSES AND DEFICITS. FOR SOME COUNTRIES, SUCH AS UK, ITALY, DENMARK, HIGHER OIL IMPORT COSTS WERE PILED ON TOP OF ALREADY WEAK OR DETERIORATING CURRENT ACCOUNT POSITIONS. ALTHOUGH INTERNATIONAL FINANCIAL INSTITUTIONS AND MARKETS COULD BE EXPECTED TO DISTRIBUTE THE BULK OF PETRODOLLAR REFLWS TO A SUBSTANTIAL NUMBER OF COUNTRIES, FINANCIALLY WEAKER COUNTRIES WERE LIKELY TO REACH THE LIMITS OF THEIR BORROWING CAPACITIES MORE RAPIDLY THAN THEY WERE ABLE TO MAKE NEEDED CURRENT ACCOUNT ADJUSTMENTS. RESERVES COULD BE DRAWN DOWN TO SOME EXTENT, BUT THEY ARE NOT GENERALLY LARGE RELATIVE TO THE FLOWS INVOLVED, AND SHARP REDUCTIONS MIGHT ENCOURAGE CAPITAL FLIGHT. ABSENT INTERNATIONAL COOPERATION TO SUPPLEMENT PRIVATE MARKET FLOWS, FINANCIALLY WEAKER COUNTRIES COULD BE FORCED INTO MAKING A CHOICE AMONG (1) ATTEMPTING A RADICAL DEFLATION OF THEIR ECONOMIES, (2) ALLOWING A DRASIC DEPRECIATION OF THEIR CURRENCIES, OR (3) IMPOSING TRADE BARRIERS AND OTHER CURRENT ACCOUNT RESTRICTIONS IN AN EFFORT TO

QUICKLY REDUCE THEIR CURRENT ACCOUNT DEFICITS. MOST LIKELY SOME COMBINATION OF THESE WOULD BE CHOSEN.

12. ALTHOUGH MODERATELY RESTRICTIVE MONETARY AND FISCAL POLICIES AND EXCHANGE RATE DEPRECIATION MIGHT WELL BE AN APPROPRIATE POLICY COURSE FOR SOME COUNTRIES FOR WHOM

SUCH ADJUSTMENTS MAY BE NECESSARY, THE INTERNAL IMPACT OF MORE DRASTIC ACTION ALONG THESE LINES WOULD BE UNNECESSARILY HARMFUL AND POLITICALLY EXPLOSIVE. MORE-OVER, ALL THREE WOULD HAVE SERIOUS EXTERNAL CONSEQUENCES. IN PARTICULAR, THE RESORT TO BEGGAR-THY-NEIGHBOR TRADE RESTRICTIONS WOULD UNDOUBTEDLY SET OFF A CHAIN OF RETALI-LIMITED OFFICIAL USE  
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ATION, ULTIMATELY WITH SEVERE DAMAGE TO INTERNATIONAL COOPERATION AND LARGE ECONOMIC COSTS.

13. SOURCES OF FINANCING. THERE ARE A NUMBER OF TYPES OF OFFICIAL FINANCING SOURCES TO BE CONSIDERED. ONE OBVIOUS SOURCE IS BILATERAL CREDITS FROM THE OIL EXPORTING COUNTRIES THEMSELVES. SUCH CREDITS CAN SERVE A USEFUL ROLE. IF GIVEN ON CONCESSIONAL TERMS TO THE POOREST DEVELOPING COUNTRIES, THEY REDUCE THE REAL BURDENS IMPOSED BY THE HIGHER OIL PRICES ON THOSE LEAST ABLE TO BEAR THEM. THEY REDUCE BURDENS ON PRIVATE FINANCIAL INSTITUTIONS, AND REDUCE THE POTENTIAL FOR DISRUPTIVE SHIFTS OF LIQUID FUNDS AMONG COUNTRIES. THEY INVOLVE OIL EXPORTING COUNTRIES IN SHARING THE CREDIT RISKS OF LENDING TO THE FINANCIALLY WEAKER NATIONS.

14. HOWEVER, HEAVY RESORT TO DIRECT BILATERAL BORROWINGS FROM OIL PRODUCERS MIGHT ALSO CREATE SEVERE PROBLEMS. IF THERE IS A COMPETITIVE SCRAMBLE FOR SUCH LOANS, OR IF COUNTRIES ARE DRIVEN TO THEM BY SEVERE FINANCIAL EMERGENCY, THEY COULD INVOLVE UNNECESSARILY HEAVY FINANCIAL BURDENS, AND PROVIDE OIL EXPORTERS WITH UNNECESSARILY HIGH RETURNS. THEY COULD ALSO WEAKEN THE POLITICAL INDEPENDENCE OF THE DEBTOR COUNTRIES, AND ERODE THE BONDS OF COOPERATION AND COHESION AMONG THE WESTERN COUNTRIES. IN PARTICULAR, THEY MIGHT MAKE IT DIFFICULT FOR DEBTOR COUNTRIES TO PARTICIPATE IN COOPERATIVE CONSUMER GOVERNMENT EFFORTS TO CONSERVE ENERGY AND DEVELOP ALTERNATIVE ENERGY SOURCES.

15. BILATERAL OFFICIAL LENDING AMONG OIL CONSUMING COUNTRIES COULD IN PRINCIPLE ALSO BE SUFFICIENT. HERE TOO, ALTHOUGH SUCH LENDING MAY PLAY A SMALL, BUT USEFUL ROLE, EXCESSIVE RELIANCE COULD BE HARMFUL. NEGOTIATIONS OF SUCH LOANS ON A LARGE SCALE COULD PUT A SEVERE STRAIN ON FRIENDLY RELATIONSHIPS.

16. THE USE OF MULTILATERAL OFFICIAL FACILITIES AVOIDS  
MANY OF THESE DIFFICULTIES. TERMS, ACCESS, AND CON-  
DITIONALITY CAN BE LAID DOWN IN ADVANCE BY MUTUAL AGREE-  
MENT OF A BROAD GROUP OF COUNTRIES, AND THE CREDIT RISK  
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CAN BE WIDELY SHARED. IT WAS GENERALLY AGREED THAT THE  
EXISTING CAPACITY OF MULTILATERAL INSTITUTIONS WHICH  
PROVIDE BALANCE OF PAYMENTS SUPPORT--MAINLY THE INTER-  
NATIONAL MONETARY FUND--WAS INSUFFICIENT TO MEET THIS NEW  
NEED. THEREFORE, NEW OR EXPANDED MULTILATERAL FINANCING  
FACILITIES WERE REQUIRED.

17. MULTILATERAL FINANCING FACILITIES. AROUND MID-1974,  
THE IMF ESTABLISHED A SPECIAL QUOTE OIL FACILITY UNQUOTE  
TO ASSIST COUNTRIES IN BALANCE OF PAYMENTS DIFFICULTIES  
RESULTING FROM THE INITIAL IMPACT OF INCREASED OIL IMPORT  
COSTS. FUNDS WERE OBTAINED BY IMF BORROWING FROM OIL  
PRODUCERS (DOLLARS THREE AND ONE-HALF BILLION AT A 7  
PERCENT RATE OF INTEREST) AND WERE MADE AVAILABLE TO  
MEMBER COUNTRIES WITHIN PREDETERMINED LIMITS AND ON A  
SEMI-AUTOMATIC BASIS TO FINANCE OIL-RELATED BALANCE  
OF PAYMENTS DIFFICULTIES. REPAYMENT WAS TO BE MADE OVER  
A 3 TO 7 YEAR PERIOD AT AN INTEREST RATE TO COVER BORROW-  
ING COSTS PLUS A SERVICE CHARGE. AT YEAR'S END, MEMBER  
COUNTRIES HAD BORROWED OVER DOLLARS 2 BILLION UNDER THE  
OIL FACILITY.

18. WHEN THE NEW IMF MINISTERIAL-LEVEL INTERIM COMMITTEE  
WAS ESTABLISHED AT THE IMF/IBRD ANNUAL MEETINGS IN  
SEPTEMBER 1974, IT WAS AGREED THAT THE POSSIBLE NEED FOR  
ADDITIONAL RECYCLING FACILITIES WOULD HAVE FIRST PRIORITY  
ON ITS AGENDA. ONE PROPOSAL, ADVANCED IN PARTICULAR BY  
BRITISH CHANCELLOR OF THE EXCHEQUER DENIS HEALEY, WAS FOR  
A MASSIVE INCREASE IN THE SIZE OF THE IMF OIL FACILITY.

19. U.S. POSITION. DURING THE MONTHS FOLLOWING THE  
ANNUAL MEETING, THE US REVIEWED ITS POSITION ON THE NEED  
FOR, AND DESIRABLE FORMS OF, MULTILATERAL FINANCING  
OPERATIONS. SEVERAL CONCLUSIONS OF THIS REVIEW INFLUENCED  
THE US PROPOSALS MADE IN NOVEMBER AND DECEMBER OF THIS  
YEAR. (1) ALTHOUGH THERE SHOULD BE CONTINUED MAXIMUM USE  
OF NORMAL CHANNELS IN THE RECYCLING PROCESS, THERE WAS A  
CLEAR NEED FOR FURTHER FACILITIES WHICH COULD SERVE AS A  
BACKSTOP OR QUOTE SAFETY NET UNQUOTE IN CASE OF EMERGENCY.  
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(2) IT WOULD BE DESIRABLE FOR A FACILITY TO BE ESTABLISHED THAT COULD BE AN INTEGRAL PART OF, AND REINFORCEMENT TO, THE COOPERATIVE INTERNATIONAL ENERGY PROGRAM-AMONG THE INDUSTRIALIZED OIL-CTNSUVIHED OUTSIDE SUCH A FACILITY SHOULD THEREFORE BE ESTABLISHED OUTSIDE THE IMF, THAT IS, AMONG THE OECD COUNTRIES. (3) IF SUCH A FACILITY WERE TO SERVE ITS PURPOSE IN PROMOTING CONSUMER SOLIDARITY, IT SHOULD NOT RELY ON ATTEMPTS TO OBTAIN DIRECT LOANS FROM OPEC MEMBERS, BUT INSTEAD TAP THE

CAPITAL AND MONEY MARKETS TO WHICH OPEC MONEYS WOULD INEVITABLY FLOW. IN ADDITION, IT WOULD BE UNDESIRABLE FOR THE IMF TO BECOME MUCH MORE HEAVILY DEPENDENT ON BORROWINGS FROM OIL EXPORTERS. (4) FINANCING AVAILABILITIES SHOULD BE TIED TO A COUNTRY'S OVERALL PAYMENTS SITUATION AND NOT ITS QUOTE OIL DEFICIT UNQUOTE. LENDING SHOULD BE LESS AUTOMATIC AND MORE CONDITIONAL ON COUNTRIES' FOLLOWING APPROPRIATE BALANCE OF PAYMENTS ADJUSTMENT POLICIES. (5) A SPECIAL MULTILATERAL FACILITY WAS NEEDED TO PROVIDE HIGHLY CONCESSIONAL ASSISTANCE TO THE POOREST, QUOTE MOST SEVERELY AFFECTED UNQUOTE DEVELOPING COUNTRIES, FOR WHOM THE TERMS OF THE EXISTING IMF OIL FACILITY WERE TOO BURDENOME.

20. IN LINE WITH THESE OBJECTIVES, THE US SPELLED OUT A QUOTE THREE TRACK UNQUOTE PROPOSAL FOR MULTILATERAL FINANCING FACILITIES. (1) THE IMF SHOULD NOT RENEW OR EXPAND ITS OIL FACILITY BUT SUBSTANTIALLY INCREASE LENDING UNDER ITS NORMAL CONDITIONAL CREDIT TRANCES, MAKING MAXIMUM USE OF EXISTING FUND RESOURCES, AND BORROWING ADDITIONAL AMOUNTS FROM OIL EXPORTERS ONLY IF ABSOLUTELY NECESSARY. EXISTING FUND RESOURCES SHOULD PROVE ADEQUATE FOR THE NEAR TERM, AND BEYOND 1975 THE INCREASE IN FUND QUOTAS NOW GENERALLY AGREED TO WOULD PROVIDE ADDITIONAL RESOURCES. (2) A DOLLARS TWENTY FIVE BILLION QUOTE FINANCIAL SOLIDARITY UNQUOTE OR QUOTE SAFETY NET UNQUOTE FACILITY SHOULD BE ESTABLISHED FOR THE OECD COUNTRIES TO SERVE AS A SUPPLEMENT TO OTHER FINANCING SOURCES IN CASE OF SERIOUS BALANCE OF PAYMENTS NEED. LOAN FUNDS WOULD BE BORROWED IN THE PRIVATE MARKET AGAINST THE GUARANTEE OF THE FACILITY OR BE MADE AVAILA-LIMITED OFFICIAL USE  
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BLE BY MEMBER GOVERNMENTS. ALL MEMBERS WOULD SHARE THE CREDIT RISK. LOANS WOULD BE CONDITIONAL ON COUNTRIES' FOLLOWING ADEQUATE ENERGY CONSERVATION AND DEVELOPMENT POLICIES, AS WELL AS APPROPRIATE BALANCE OF PAYMENTS ADJUSTMENT POLICIES. DECISIONS ON LENDING WOULD BE BY WEIGHTED VOTE. (3) A SPECIAL IMF-MANAGED TRUST FUND SHOULD BE ESTABLISHED TO PROVIDE HIGHLY CONCESSIONAL

ASSISTANCE TO THE POOREST DEVELOPING COUNTRIES. FUNDS WOULD BE DERIVED IN PART FROM THE PROFITS OF SALES OF IMF GOLD, AND FROM DIRECT CONTRIBUTIONS FROM OTHER COUNTRIES IN A POSITION TO CONTRIBUTE, OIL EXPORTERS ESPECIALLY.

21. OTHER COUNTRIES' POSITIONS. THE US POSITION ON THE APPROACH TO RECYCLING THROUGH THE IMF DID NOT ATTRACT SUPPORT AMONG OTHER IMF COUNTRIES. THEY FELT, RATHER,

THAT QUOTE OIL DEFICITS UNQUOTE RETAINED SIGNIFICANCE AS A GUIDE TO FINANCING NEEDS AND PREFERRED THE SEMI-AUTOMATICITY OF THE OIL FACILITY TO THE CONDITIONALITY OF NORMAL IMF LENDING. THEY WANTED TO RESERVE THE FUND'S OWN RESOURCES FOR NORMAL DRAWINGS, AND BORROW TO FINANCE OIL FACILITY DRAWINGS. SOME OF THEIR PREFERENCE FOR CONTINUED IMF DIRECT BORROWINGS FROM OIL PRODUCERS PROBABLY REFLECTED A DESIRE TO AVOID THE APPEARANCE OF CONFRONTATION WITH OIL PRODUCERS.

22. ON THE OTHER HAND, THE US PROPOSAL FOR AN OECD QUOTE SAFETY NET UNQUOTE WAS GREETED WITH MORE INTEREST. THE G-10 SET UP A WORKING GROUP TO CONSIDER THE DETAILS OF THE US PROPOSAL, AS WELL AS A SIMILAR PROPOSAL BY OECD SECRETARY GENERAL VAN LENNEP. THE EUROPEAN COUNTRIES MADE CLEAR, HOWEVER, THAT THEY VIEWED THIS PROPOSAL AS SUPPLEMENTARY TO EXPANSION OF THE IMF OIL FACILITY, WHICH THEY HAD AGREED TO SUPPORT.

23. NOT MUCH REACTION WAS REGISTERED TO THE US PROPOSAL FOR A TRUST FUND FOR THE POOREST DEVELOPING COUNTRIES. HOWEVER, FRANCE AND ITALY EXPRESSED STRONG RESERVATIONS ON THE USE OF IMF GOLD TO HELP PROVIDE RESOURCES FOR THE TRUST FUND. THIS POSITION REFLECTED FRANCE'S LIMITED OFFICIAL USE

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DESIRE TO MAINTAIN A PROMINENT ROLE FOR GOLD IN THE INTERNATIONAL MONETARY SYSTEM, BUT MORE IMPORTANTLY THE RELUCTANCE OF BOTH COUNTRIES TO SEE DOWNWARD PRESSURE ON THE FREE MARKET GOLD PRICE EXERTED BY OFFICIAL SALES.

24. ALTERNATIVE PROPOSALS PUT FORWARD TO PROVIDE AID TO THE POOREST DEVELOPING COUNTRIES INCLUDED A FUND PROPOSAL TO ESTABLISH A SPECIAL ACCOUNT IN CONNECTION WITH THE OIL FACILITY, WITH APPROPRIATE CONTRIBUTIONS BY OIL EXPORTING AND INDUSTRIAL COUNTRIES, TO BE USED TO REDUCE THE BURDEN OF INTEREST PAYABLE BY THE POOREST COUNTRIES UNDER THE FACILITY.

25. THE JANUARY 1975 DECISIONS. IN VIEW OF OUR MINORITY POSITION ON THE ISSUE, AND OUR DESIRE TO OBTAIN FINAL AGREEMENT TO AN OECD QUOTE SAFETY NET UNQUOTE, THE US

WITHDREW ITS OPPOSITION TO EXPANSION OF THE IMF OIL FACILITY. IN THE JANUARY 15-16 MEETING OF THE IMF INTERIM COMMITTEE A DOLLARS 6 BILLION EXPANSION WAS AGREED TO FOR 1975 ONLY, SMALLER THAN HAD BEEN PROPOSED. THE COMPROMISE ALSO INCLUDED THE POSSIBILITY THAT BORROWINGS FROM OTHER COUNTRIES--NOT JUST OIL EXPORTERS--BE TAPPED, AND THAT REVIEW OF FUND PRACTICE BE UNDERTAKEN WITH A VIEW TOWARDS MAKING INCREASED USE OF THE FUND'S OWN

CURRENCY HOLDINGS. THE FUND'S RESOURCES WOULD ALSO BE AUGMENTED BY A 32.5 PERCENT INCREASE IN FUND QUOTAS, SUBJECT TO SATISFACTORY AMENDMENT OF THE FUND ARTICLES. THE FUND PROPOSAL FOR A SPECIAL ACCOUNT TO REDUCE THE INTEREST BURDEN PAYABLE BY MSA'S UNDER THE OIL FACILITY WAS ENDORSED.

26. THE G-10 MINISTERS, MEETING EARLIER THE SAME WEEK, AGREED THAT A DOLLARS TWENTY-FIVE BILLION OECD SAFETY NET SHOULD BE ESTABLISHED, BASICALLY ALONG THE LINES OF THE US PROPOSAL. IT WAS AGREED THAT THE NEW FINANCIAL ARRANGEMENT, OPEN TO ALL OECD MEMBERS, SHOULD BE SET UP AT THE EARLIEST POSSIBLE DATE, TO BE AVAILABLE FOR A PERIOD OF TWO YEARS. ITS PURPOSE WOULD BE TO SUPPORT THE DETERMINATION OF PARTICIPATING COUNTRIES TO PURSUE APPROPRIATE DOMESTIC AND INTERNATIONAL ECONOMIC POLICIES, INCLUDING LIMITED OFFICIAL USE  
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COOPERATIVE POLICIES TO ENCOURAGE THE INCREASED PRODUCTION AND CONSERVATION OF ENERGY. THE ARRANGEMENT WOULD BE USED AS A LAST RESORT, WITH MEMBERS IN SERIOUS BALANCE OF PAYMENTS DIFFICULTIES REQUIRED TO SHOW THEY WERE MAKING FULLEST APPROPRIATE USE OF THEIR OWN RESERVES AND OF RESOURCES AVAILABLE TO THEM THROUGH OTHER CHANNELS. EACH MEMBER WOULD HAVE A QUOTA, BASED MAINLY ON GNP AND FOREIGN TRADE, WHICH WOULD DETERMINE ITS OBLIGATIONS AND BORROWING RIGHTS AND ITS RELATIVE WEIGHT FOR VOTING PURPOSES. DECISIONS ON THE GRANTING OF SPECIFIC LOANS WOULD REQUIRE A TWO-THIRDS MAJORITY VOTE FOR LOANS UP TO THE BORROWER'S QUOTA, A VERY STRONG MAJORITY FOR THE GRANTING OF LOANS IN EXCESS OF QUOTA UP TO 200 PERCENT OF QUOTA, AND BEYOND THAT, A UNANIMOUS DECISION. ALL PARTICIPANTS WOULD JOINTLY SHARE THE DEFAULT RISKS ON LOANS UNDER THE ARRANGEMENT IN PROPORTION TO, AND UP TO THE LIMITS OF, THEIR QUOTAS.

27. SOME IMPORTANT SPECIFIC DETAILS OF THE OECD SAFETY NET WERE LEFT TO BE WORKED OUT, INCLUDING PRECISE FINANCING METHODS. THESE MIGHT INCLUDE DIRECT CONTRIBUTIONS OR JOINT BORROWING IN CAPITAL MARKETS OR BOTH. AN AD HOC OECD WORKING GROUP WILL PREPARE A DRAFT AGREEMENT IN TIME TO PERMIT APPROVAL BY THE OECD COUNCIL BY

THE END OF FEBRUARY 1975.

28. THE US TRUST FUND PROPOSAL WAS CONSIDERED TOGETHER WITH OTHER MATTERS RELATING TO MSA PROBLEMS IN THE MEETING OF THE JOINT BANK/FUND DEVELOPMENT COMMITTEE ON JANUARY 16. IT WAS REFERRED TO THE BANK AND FUND BOARDS FOR FURTHER STUDY.

29. CONCLUSION. WHILE THE US HAS NOT ACHIEVED ITS FULL RANGE OF GOALS AS REGARDS ITS RECYCLING PROPOSALS, THE DECISIONS OF JANUARY 13-17 HAVE GREATLY STRENGTHENED THE ABILITY OF THE WORLD'S FINANCIAL SYSTEM TO DEAL WITH RECYCLING PROBLEMS. PRIVATE MARKETS WILL STILL APPROPRIATELY HANDLE THE BULK OF THE RECYCLING PROCESS, SUPPLEMENTED BY VARIOUS FORMS OF DIRECT OFFICIAL LENDING, FOR EXAMPLE, FROM OIL EXPORTERS TO INDIVIDUAL COUNTRIES OR TO GROUPS OF COUNTRIES SUCH AS THE EC. THE MULTI-  
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LATERAL ARRANGEMENTS IN THE IMF AND OECD WILL SUPPLEMENT THESE CHANNELS, OFFERING ADDED INSURANCE AGAINST FINANCIAL CRISES, USEFUL ALTERNATIVES TO EXCESSIVE DEPENDENCE ON BILATERAL DEALS, AND VALUABLE INCENTIVES TO APPROPRIATE PAYMENTS AND ENERGY POLICIES. WHAT IS STILL LACKING IS AN ADEQUATE FRAMEWORK FOR RELIEVING THE ESPECIALLY HEAVY BURDEN ON THE POOREST DEVELOPING COUNTRIES. THIS WILL CONTINUE TO BE A HIGH PRIORITY OF INTERNATIONAL ACTION IN THE COMING MONTHS. KISSINGER

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## Message Attributes

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**Disposition Case Number:** n/a  
**Disposition Comment:** 25 YEAR REVIEW  
**Disposition Date:** 28 MAY 2004  
**Disposition Event:**  
**Disposition History:** n/a  
**Disposition Reason:**  
**Disposition Remarks:**  
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**Document Source:** ADS  
**Document Unique ID:** 00  
**Drafter:** OMA:GPBALABANIS:BMH  
**Enclosure:** n/a  
**Executive Order:** N/A  
**Errors:** n/a  
**Film Number:** D750025-0323  
**From:** STATE  
**Handling Restrictions:** n/a  
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**Line Count:** 522  
**Locator:** TEXT ON-LINE, TEXT ON MICROFILM  
**Office:** ORIGIN EB  
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**Previous Handling Restrictions:** n/a  
**Reference:** n/a  
**Review Action:** RELEASED, APPROVED  
**Review Authority:** johnsorg  
**Review Comment:** n/a  
**Review Content Flags:**  
**Review Date:** 25 JUN 2003  
**Review Event:**  
**Review Exemptions:** n/a  
**Review History:** RELEASED <25 JUN 2003 by ShawDG>; APPROVED <04 NOV 2003 by johnsorg>  
**Review Markings:**

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**Review Media Identifier:**  
**Review Referrals:** n/a  
**Review Release Date:** n/a  
**Review Release Event:** n/a  
**Review Transfer Date:**  
**Review Withdrawn Fields:** n/a  
**Secure:** OPEN  
**Status:** NATIVE  
**Subject:** n/a  
**TAGS:** EFIN, ENRG, EINV, US, XX  
**To:** ALL DIPLOMATIC AND CONSULAR POSTS  
TUNIS BY POUCH  
**Type:** TE  
**Markings:** Margaret P. Grafeld Declassified/Released US Department of State EO Systematic Review 05 JUL 2006